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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
1998 Biennial Regulatory Review— Review of Accounting and Cost Allocation Requirements	)	CC Docket No. 98-81
	)	ASD File No. 98-64
United States Telephone Association Petition for Rulemaking	)	

COMMENTS OF BELL ATLANTIC

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COMMENTS OF BELL ATLANTIC[1]

After the most turbulent decade in the history of telecommunications regulation, in the first major review of its detailed rate-of-return-era accounting requirements for large local exchange carriers, the Notice proposes just three minor changes including the elimination of a single account that is no longer in use. While Bell Atlantic supports the proposed changes, the Notice simply fails to address the fundamental overhaul of these outdated rules that is needed. In order to comply with the Act's requirement to only retain those regulations that are necessary, the Commission should replace the myriad detailed record keeping requirements currently imbedded in Part 32 with a few simple rules that require accounting in accordance with Generally Accepted Accounting Principles ("GAAP"). These rules will eliminate millions in unnecessary record keeping expenses,

[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

while still providing the Commission with an auditable accounting standard to the extent there is any continuing need in a pure price caps world.

I. The Commission Should Reform Part 32 To Reflect The Fundamental Changes In Regulation Since Its Adoption

The proposed changes fail to take on the fundamental reform of Part 32 that is needed. The Notice readily acknowledges that Class A accounting requirements have been maintained, more or less unchanged, since the Commission revised its uniform system of accounts "*more than ten years ago.*" Notice, ¶ 5 (emphasis added). Moreover, many of the accounting details date back to the inception of the initial uniform system of accounts more than fifty years ago. What the Notice fails to acknowledge, much less adequately address, are the fundamental changes to the telecommunications market and its regulation that have occurred since that time.

When these regulations were adopted, large local exchange carriers were under rate of return regulation. Under rate of return, rates are set based on the level of accounting costs. Since then, regulation of these carriers has evolved, and these carriers are now subject to pure price caps (without any "sharing" requirement). Under price cap regulation, rate changes are based on national inflation and an industry-wide productivity factor. As the Commission has repeatedly acknowledged, price cap regulation "severs the direct link between regulated costs and prices." *Implementation of the Non-Accounting Safeguards of Sections 271 and 272*, 11 FCC Rcd 18877, 18942 (1996) (quoting *Computer III Remand Proceedings,* 6 FCC Rcd 7571, 7596 (1991)).

The proposals in the Notice do not take into account this fundamental change . Nor do they take into account the fact that the high productivity targets set by the Commission require carriers to improve efficiency and weed out unnecessary costs in order to meet these targets. And it is contrary to the whole theory of encouraging carriers to improve efficiency to simultaneously impose requirements (and costs) that are far in excess of what is required by standard business accounting practice.

The other fundamental regulatory change is the passage of the Telecommunications Act, and its emphasis on market forces rather than regulation as a means of guiding company behavior. The Act requires the Commission to conduct a biennial review of "all regulations" issued under the Communications Act that apply to "any provider of telecommunications service" and determine whether the regulations are "necessary" to serve the "public interest." *See* 47 U.S.C. § 161. As the Commission itself has recognized in other contexts, a regulation is not "necessary" if the underlying policy concern can be addressed in another manner with less regulation. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 11 FCC Rcd 20730, 20742-47 (1996) (competition and the availability of complaint proceedings make mandatory tariffs unnecessary for interexchange carriers). And individual regulations do not even serve the public interest – let alone satisfy the requirement that they be "necessary" to serve the public interest – unless "their benefits significantly outweigh their costs." *Computer III Further Remand Proceedings*, 13 FCC Rcd 6040, 6121, Separate Statement of Commissioner Furtchtgott-Roth (1998).

There is no evidence in the Notice that there has been *any* balancing of costs and benefits with respect to Part 32 burdens imposed on large local carriers. And neither of the reasons it cites justifies retaining the existing accounting requirements.

1. The current rules are not required to prevent cross subsidization. The Notice cites various provisions of the Act designed to ensure that that local carriers do not cross-subsidize "non-regulated" services by shifting costs to regulated local exchange services. There are three answers to this.

First, the Commission has already addressed any cross subsidy concerns through its move to pure price cap regulation. As economists have widely recognized, "[w]ith price caps, cost-shifting is no longer a possibility since prices cannot be affected by any manipulation of cost accounts." Bell Atlantic Comments, Affidavit of Robert W. Crandall, ¶ 8, CC Docket No. 96-21 (filed Mar. 13, 1996)(attached to Comments of Bell Atlantic). Consequently, as Professor Alfred Kahn has explained, a price cap regulated local exchange carrier "is no more able to cross-subsidize than an unregulated firm." Affidavit of Alfred E. Kahn, ¶ 27, CC Docket No. 94-1 (filed June 29, 1994) (attached to Reply Comments of Bell Atlantic).

In fact, the Commission itself has recognized that the implementation of price cap regulation severs the "direct link between any improperly sifted costs and regulated basic service prices" thereby undermining the incentive to cross-subsidize. *Computer III Remand Proceedings*, 6 FCC Rcd 174, 179 (1990). Indeed, the primary reason that the Commission elected to retain *any* cost accounting safeguards was because the prior price cap rules permitted local exchange carriers to "select among three productivity factor choices, two of which impose sharing obligations." *Accounting Safeguards Under the Telecommunications Act*, 11 FCC Rcd 17539 at ¶ 271 (1996) ("Accounting Safeguards

Order).[2] With sharing now completely eliminated, the Commission should, at a minimum, begin a complete streamlining of these burdensome rules.[3]

Second, the Part 32 rules are not necessary to ensure that the costs of the non-regulated services are properly accounted for. For example, section 272 requires that in-region long distance service be provided through a separate affiliate with its own books of account (as well as public disclosure of transactions between that affiliate and the local exchange provider, and a biennial audit). But as the Commission itself found, there is no need to lard on rigid Part 32 accounting rules. On the contrary, it concluded that there is "*no* reason to impose the additional burden" of requiring the separate affiliates to keep those financial books "in accordance with the Part 32 Uniform System of Accounts." Accounting Safeguards Order, ¶170 (emphasis added). Instead, employing normal business accounting using generally accepted accounting principles "will result in a uniform audit trail at minimal cost." *Id.*

Third, local exchange carriers have long been allowed to provide a variety of unregulated services without any of the anticompetitive consequences predicted by the proponents of the cross-subsidy theory. For example, the large local exchange carriers

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2 The Commission also cited the ability of local exchange carriers to seek prices outside normal price cap regulation through above cap filings or lower formula adjustments. But both of these limited exceptions offer the Commission the opportunity to scrutinize any cost submission, and do not serve as a basis to maintain rules that are unnecessary under routine circumstances.

3 Overly complex cost allocation is expensive. For example, ongoing implementation of Part 64 requirements cost Bell Atlantic over $9 million a year. These costs could be cut dramatically by moving to less detailed frozen allocations. *See, e.g., Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Comments of Bell Atlantic (filed Dec. 10, 1997).

have participated in cellular telephony since 1983. Despite their head start, they have not come to dominate the market, as would have happened if they had subsidized these services from their local telephone services. In fact, non-wireline suppliers have market shares that, on average, are the same as and often larger than the local exchange carrier operating in its home territory. *See* Affidavit of William Taylor at 14, CC Docket No. 96-149 (filed Apr. 17, 1997) (attached to Bell Company Comments on Expedited Reconsideration). Another example is the market for customer premises equipment ("CPE"). The Justice Department had opposed Bell company entry into this market because of their alleged ability to harm competition. *See United States v. AT&T*, 552 F. Supp. 131, 191-193 (D.D.C. 1982). More than a decade after being allowed to enter the market, however, the average market share of the Bell companies is less than one percent and CPE output has risen while prices have fallen. NATA, 1995 *Telecommunications Review and Forecast*, Vol. 128 (1995).

2. The current rules impose an undue burden. The Notice also suggests that the current rules do not impose an undue burden because "incumbent LECs maintain their financial records in significantly more detail than that required for Class A carriers in our Part 32 rules." Notice, ¶ 6. In reality, the detail required by Part 32 rules far exceeds what Bell Atlantic maintains for its own business purposes. Moreover, the accounts required by Part 32 do not even correspond with the accounts used for financial reports which are organized according to the needs of the business in accordance with GAAP. As a result -- and, as the Commission itself has recognized -- Part 32 regulations impose "additional burdens" beyond GAAP accounting.

In a white paper filed in this proceeding, the accounting firm of Arthur Andersen concluded that Part 32 imposes "significant record keeping requirements" that carry "significant costs." Arthur Andersen LLP, "Accounting Simplification in the Telecommunications Industry" at 1, *ex parte* filed July 15, 1998 ("Arthur Andersen"). In contrast, other industries use "far less detailed" accounting systems. Arthur Andersen at 13. Clearly, the same must be true of non-regulated competitors in the same industry. Moreover, even where the regulated books mirror GAAP, carriers must seek special FCC approval to adjust for GAAP changes. The result is the additional burden of keeping two sets of financial books under different rules. Local carriers are thereby disproportionately burdened, which hinders competition and ultimately hurts consumers.

II. The Commission Should Adopt A Single Accounting System For Regulatory Reporting Based On GAAP

Rather than tinker around the edges of regulatory reform, three fundamental reforms are needed to comply with the Congressional mandate to remove all regulatory requirements that are not "necessary" to serve the public interest.

First, there is no reason to continue to have separate, and more burdensome, financial requirements for the larger local exchange carriers (so called "class A" carriers). Unlike the smaller and mid-sized carriers (so called "class B" carriers), larger carriers are subject to mandatory price cap regulation. There is no policy justification for imposing more stringent reporting and record keeping burdens on the subset of carriers whose accounting costs are completely irrelevant to normal price setting.

The Notice justifies keeping this anachronistic dichotomy based solely on the assertion that "mid-sized carriers typically conduct a lower volume of transactions involving competitive products and services than the large incumbent LECs." Notice, ¶ 5. Even assuming the volume of transactions had anything to do with the level of accounting detail, the conclusion does not square with the fact that the large local exchange carriers actually report a lower percentage of costs associated with nonregulated services than do the small and mid-sized carriers.[4]

Second, for all local exchange carriers, the Commission should overhaul its accounting requirements and simply require that regulated books and records be kept in accordance with GAAP. GAAP is already relied on by the Commission for oversight of local exchange carrier subsidiaries,[5] and by other regulatory agencies for broader financial oversight.[6] Furthermore, the Federal Accounting Standards Board (FASB) provides a process through which proposed changes in GAAP are exposed for debate, discussion and evaluation. Such standards are not arbitrarily established, and these standards apply to all companies that must follow GAAP. As Arthur Andersen demonstrates, "GAAP ensures that accounting transactions are recorded and reported in an objective and consistent manner, while also ensuring the auditability of such transactions and the underlying accounting and reporting processes." Arthur Andersen at 17.

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4 Seven percent of the Total Expenses for the Bell Companies and GTE are nonregulated, while ten percent of Total Expenses for the remaining (class B) companies are nonregulated. *See* 1997 ARMIS 43-03, Line 750, Column j divided by Column b.

5 *See* Accounting Safeguards Order, ¶ 170.

6 For example, the Security and Exchange Commission monitors companies based on GAAP records. *See* Accountants SEC Practice Manual, ¶ 4001.

Part 32 was established in an era where the largest local carriers reflected a common heritage. Ten years later, the children of Ma Bell have gone their own way. Not all carriers use the same software packages for record keeping or structure their businesses in the same way. Carriers offer different products and services. GAAP has sufficient flexibility to reflect those differences. And the Commission can still monitor results by using a high-level reporting structure. Carriers would use their internal Chart of Accounts and GAAP to prepare one annual regulatory report.

Third, the Commission should eliminate the detailed rules for maintaining continuing property records. Not only are these records completely irrelevant to rate setting under current price cap regulation, but even under rate of return regulation these engineering records had no impact on costs or rate base. These engineering records are separate and distinct from the financial records, which are based on actual payments to vendors, and do not rely on the engineering records to determine costs.

Despite their irrelevance, the Notice does not propose any change to rules that impose vague and open-ended requirements to keep certain property records in perpetuity. As Arthur Anderson explains, the Commission's current property record keeping requirements "are not, in most cases, beneficial to the LECs for purposes of managing their assets or running their business." Arthur Andersen at 31. Not surprisingly, this means that local carriers "are saddled with extremely high costs to manage the fixed assets." Arthur Andersen at 32. For example, Bell Atlantic today spends more than $8 million a year to maintain its continuing property records.

Under GAAP, all companies, including regulated carriers, "must maintain sufficient internal controls in order to safeguard assets and ensure that their financial accounts and records are accurately stated." Arthur Andersen at 31. The Commission should repeal its current rules and rely on this basic standard.

Conclusion

The Commission should replace its current accounting and record keeping requirements with a simplified mandate to maintain records in accordance with GAAP.

Respectfully submitted,

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July 17, 1998

CERTIFICATE OF SERVICE

I hereby certify that on this 17th day of July, 1998 a copy of the foregoing "Comments of Bell Atlantic" was served on the parties on the attached list.

Jennifer L. Hoh

Jennifer L. Hoh

* Via hand delivery.

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